



Status Update – Evansville Downtown Hotel
Advisory

December 16, 2011



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Bob Goldman
President, Evansville Redevelopment Commission

Sent via Email to: bgoldpaw@sbglobal.net

Dear Mr. Goldman:

The Evansville Redevelopment Commission engaged Hunden Strategic Partners (HSP) to provide advisory services related to its downtown hotel development process, including review of developer proposals and related items. While HSP was not engaged to conduct and write a report, this update is being provided to shed light on our work and conclusions without putting the confidentiality of certain private matters in jeopardy.

This update has been prepared under the following general assumptions and limiting conditions:

- The findings presented herein reflect analysis of primary and secondary sources of information. HSP utilized sources deemed to be reliable but cannot guarantee their accuracy. In several instances, additional supporting data was requested if the data could not be verified.
- This update shall not be used for any other purpose other than the stated purpose: an update on the process.
- The proposals being reviewed were made public on the ERC's website, so any data within those proposals was assumed to be public knowledge. Private company and personal financial information not provided in the proposals were not made public by the ERC and will not be made public here.

We have enjoyed serving you on this engagement and look forward to providing you with continuing service.

Sincerely yours,
HUNDEN STRATEGIC PARTNERS

CC: Mayor John Weinzapfel

Attachment

EVANSVILLE DOWNTOWN HOTEL PROCESS ADVISORY UPDATE

Introduction

The Evansville Redevelopment Commission (ERC) engaged Hunden Strategic Partners (HSP) to advise it on the process of inducing the development of a downtown full-service hotel to support the new Ford Center arena and the Centre (convention center). The initial attempt was not successful and the ERC was concerned that the current crop of proposals may not be successful either, primarily due to financing concerns. They also were concerned about the lack of experience in the proposers, neither of whom had developed a hotel previously.

Having experience working with more than a dozen cities on public-private hotel developments, Hunden knows the pitfalls and opportunities associated with such an endeavor. There are many questions and factors to be considered. The process undertaken by the community can impact the results as much as the proposers.

Brief Understanding

HSP was brought into the process midstream, after much had occurred to set the state for the current set of choices.

Having not completed a market and financial feasibility study for the project, the ERC determined the amount of subsidy for the project by the responses received from the initial crop of developers (prior to HSP's involvement). The respondents suggested that the range of subsidy for the project could range from \$8 to \$14 million for a project of 220 rooms and costing approximately \$30 million. With this information, the ERC issued a modified request for developers (RFP) that suggested public participation of \$8 million (via loans) that would assist the developers in achieving private financing for the remaining amount.

The RFP attracted two local teams to respond; however other experienced development teams that had shown prior interest did not respond. One of the suggested reasons for the lack of response was that these more experienced teams had suggested that a larger subsidy would be needed to make the project financially feasible. Without a larger subsidy, the implication was there was no incentive for them to respond. This left two teams with developers with no prior hotel development experience. Based on the results, the ERC had several questions:

- Are either of the teams/proposals worthy of consideration? That is, does the combination of experience, team members, financing and other factors give enough confidence that they should proceed to serious consideration?
- The key question for both was the viability of the financing plans. This includes several components, including the method, format and strength of the financing. The other factors, including experience, brand, design, management, etc. were important but without financing, were moot. So, how real was the financing proposed?

HSP and subcontractor London Witte undertook a review of the proposals and the teams that included reviewing all key elements of the proposals and teams. The consulting team also interviewed the teams in person, interviewed their financial consultants, interviewed the funding sources and reviewed additional confidential documentation related to the project sponsors.

In order to provide a proper context for the investigation, analysis and advisory, HSP also conducted a summary market and financial analysis to determine internally our view of the feasibility of the project. The analysis details can be provided and were provided in executive session to the ERC. In short, the analysis suggested that the value of the project is approximately \$20 - \$23 million (depending on a number of assumptions), suggesting that for a \$33 million project, the subsidy necessary to induce a strong developer to the project would range from \$9 to \$13 million, which is \$2 million to \$5 million more than the subsidy proposed by the ERC in the RFP. With this context, HSP was just as concerned as the ERC about the funding proposed for the project. Was it enough? If it was not, was there additional capacity and willingness by the developers to fund any overage? What was clear from our analysis is that if neither of the two developers worked out in negotiations, the ERC would have to propose a minimum of \$2 million more in subsidy to attract other developers and as much as \$5 million more.

This context provided some level of concern that the two developers might be overly optimistic in their valuation assumptions (and upon review, some assumptions were optimistic), which led our team to ask a number of questions to both teams about their construction and development budgets as well as their financial assumptions. (Like most of the work conducted for the ERC, the time and expertise utilized was in these investigations, reviews of documents and communication with the various parties.)

The financing concern was paramount and this was the core issue of our interviews, follow up requests for data, etc.

In the meeting with Kunkel, as well as follow up calls and data acquisition, we were made relatively comfortable about both the structure and the funding ability of the proposed financing. This was based on the following:

- Kunkel included a conventional loan via a financing company that committed to a loan-to-value ratio of 75 percent. This is much higher/better than we would have expected given the financing retraction by lenders over the past three years. We verified the commitment and ability of the financing company to fund the loan. Just this component suggested a higher valuation of the project than our models, which was encouraging (our models assumed a 65 percent loan to value, which is more consistent with the few other banks providing hotel loans across the U.S.). The loan commitment was contingent upon an appraisal to be conducted, from which the 75 percent would be calculated.
- Kunkel committed to providing the remainder of the budget via their equity contribution. At the time, the availability of funds was verified via bank statements.
- The timing of the funding appeared to be immediate, subject to the appraisal and provision of funds by the ERC.

While there were still concerns about the lack of experience and other factors of the Kunkel proposal, it appeared they at least met the threshold question of financing. The other items could be 'negotiated up', as it were. The full list of concerns and results of the financial investigation were presented to the ERC in executive session.

In the meeting with Prime, as well as follow up calls and data acquisition, we were not provided confidence in the funding structure. This was based on the following:

The EB5 funding concept, while not new, came with concerns, mostly based on timing and surety of the commitment.

- The timing of the funding is not based only on private sector factors per se (appraisals, etc.), but on a government-based bureaucratic process of approvals with no consistent track record on timing or commitment to fund. So while the rate of interest and amount of the loan was competitive, the timing could not be determined. Approval of the project itself could not be guaranteed. Compared with the private commitment (if project and developer meet 'x' then we will provide 'y' funds within 'z' days), this had very little predictability of timing or guarantee of occurrence.
- The consultants provided by the team were not able to effectively answer our questions about these primary concerns. There we simply no confidence provided about the reality of this financing mechanism.
- There were several other less material concerns and like the Kunkel situation, those merited discussion and a desire to mitigate, but not approval or disapproval.

Interesting, during the interview, when asked why Prime did not propose a conventional loan with equity, the response was that this would require \$4 to \$6 million more in subsidy than was being offered. We confirmed that they had no intention or belief that a conventional loan could work with this project.

Based on these very important threshold issues, we could not recommend the Prime proposal, despite the fact that their team and plan had many other excellent and well thought out components, including an excellent management company.

This left the ERC with a choice between Kunkel, who had so far demonstrated they passed the initial review, and starting over, with the knowledge that starting over would require several additional months and several more million dollars of subsidy. While the timing was not as much a concern, keeping the public subsidy in check was. There was a strong thought by our team that further investigation of Kunkel proposal was merited. This would consist of several components:

- Asking them at their cost, via their lender, to complete an appraisal. Once the appraised value would come back, the lender should commit to a loan amount, which would then reveal how much equity Kunkel would be required to commit. This should reveal whether or not the numbers really would work (both the Kunkel equity and the ERC subsidy).
- Asking for additional financial detail from Kunkel related to their committable funds.

- Providing critical review and requests for Kunkel to reconsider certain aspects of their proposal that could be improved.

The ERC agreed that we should proceed with these items that were designed to determine the viability of their proposal (and begin negotiating, conceptually at least, improvements to it). The ERC also agreed after our presentation that the concerns regarding the EB5 funding were too great to continue considering the Prime team.

HSP continued as requested until the appraisal came back. As this is a private document, we cannot share the results publicly other than to suggest that they allowed the conversation to continue. (We are disheartened that private information was provided to the press by an unknown person or persons, which could harm the process and the eventual negotiation. We do not condone this and have been careful not to provide such information to anyone who has not signed a confidentiality agreement).

About the same time as the appraisal came back, HSP issued a much more detailed financial data request to Kunkel and its lender, while also requesting changes to improve the proposed project and team. Again, there had not been an award or even a blessing of the Kunkel proposal to date, just a steady march to verify financials, improve potential project components and drive toward deal points that would either make or break a recommendation to move forward with Kunkel in detailed negotiations.

At any point during this investigation and discussion, a red flag could have stopped the process. While there were many questions, none suggested the process should stop and start over. As we have stated throughout, the deal points contemplated by the ERC require the developer to provide their financing and funds at a time and in an amount acceptable to the ERC. If the developer cannot meet this requirement as well as the other requirements as negotiated, then the process will stop and the ERC will need to re-issue a modified RFP with a much greater subsidy. However, to date, the Kunkel group has cooperated and provided us and a majority of the ERC with the confidence to at least move to this level of discussion. Our investigation of a number of items will continue as appropriate.

In any public-private complex real estate development process, both sides are wise to take incremental steps toward a deal in concert. First is the Memorandum of Understanding (MOU), Memorandum of Agreement (MOA) or Letter of Intent (LOI). A next step is a conceptual set of agreements. Finally, the detailed and final set of agreements is agreed to. Currently we are working only on an MOU for consideration by both parties.

No step guarantees the next step will be completed, although it points both parties in the same direction. It is a continuous negotiation and involves working through details. If a "deal killer" appears after a conceptual understanding (MOU) has been agreed to, then the deal can cease. To date, there have been no deal killers that have stopped the process. However, there are still significant details to be negotiated.

HSP has been working with ERC attorneys and Kunkel's attorney to craft an MOU that lays out the general terms of a future agreement. Key elements include a requirement for all parties to fund their contributions simultaneously, for Kunkel to fund any budget overages and a limit to the ERC's financial



contribution (in the form of the two loans suggested in the original RFP). The MOU should be ready for approval by your next meeting and we recommend approval.